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TAGS: ENRG EINV EPET ECON ES
SUBJECT: ELECTRICITY DISTRIBUTORS CONTEST RATES CUTS

REF: A. SAN SALVADOR 2383
¶B. SAN SALVADOR 2300

Classified By: AMBASSADOR CHARLES L. GLAZER, Reason 1.4(d)

¶1. (U) SUMMARY: Electricity distribution companies are contesting a decision by El Salvador's utility regulator to cut power distribution rates for the next five years. The companies have appealed to the Supreme Court and the GOES to reverse the decision to sharply reduce rates beginning on January 1, 2008. They have criticized legal and technical errors in the tariff reset process and faulted the regulator for declining to negotiate a reasonable compromise. The companies warn that the rate cuts will threaten the financial viability of distribution companies and seriously undermine future development of the energy sector, while providing negligible savings to most consumers. END SUMMARY.

ELECTRICITY COMPANIES CHALLENGE PROPOSED RATE CUTS
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¶2. (U) On December 4, El Salvador's electricity regulator (Superintendencia General de Electricidad y Telecomunicaciones or SIGET) announced new distribution tariff schedules that it said will reduce average distribution rates by 18% during the next five years (ref A). SIGET says the new rate schedule resulted from an objective technical evaluation of assets and costs of distribution companies. El Salvador's two main electricity distribution companies, U.S.-based AES Corporation (which distributes roughly 75% of El Salvador's electricity) and U.K.-based Ashmore Energy (owner of Del Sur) have criticized technical errors in the tariff reset process. Both have appealed to courts and the government to prevent the application of the new tariff schedule beginning on January 1, 2008.

¶3. (SBU) AES and Ashmore separately petitioned the Constitutional Chamber of the Supreme Court to block application of the new tariffs, arguing that the tariff reset process violated their constitutional rights. They say the new rates will reduce the gross income of their Salvadoran subsidiaries by over 30% with dire consequences for the energy sector. The companies warn that the new rates will wipe out their investment budget and eliminate future dividend payments to local and international investors. On December 21, Fitch Ratings issued a negative rating watch for AES El Salvador citing increased regulatory risk and higher debt to earnings ratio after the unexpectedly sharp reduction in distribution tariffs. Ashmore manager Roberto Figueroa told Econoff on January 9 that Ashmore may limit payments to generators and apply other emergency measures in order to stay afloat.

¶4. (U) In meetings with Econoffs, AES and Ashmore managers criticized "multiple legal and technical errors" that caused SIGET's consultant to underestimate the assets and operating

costs of distribution companies. They noted SIGET used a "tolerated loss" rate of only 5%, well below the 10% rate typical for electricity distribution companies in Latin America. Under the new rate schedule, distribution companies will be expected to pay for energy losses above this 5% rate which AES characterized as "technically unfeasible". AES reiterated these concerns in a December 18 meeting with the Ambassador.

¶5. (SBU) AES also faulted SIGET for undervaluing company assets - wiping its stock of electricity meters off the books and reducing the length of its distribution network to below levels acknowledged during the last tariff reset in 2002. According to distributors, SIGET underestimated maintenance costs by assuming the distributors would subcontract to companies providing lower wages and reduced benefits. Both companies requested technical explanation for these decisions but complained that SIGET failed to adequately justify these changes from previous practice. They suggested that SIGET lacks the technical expertise to critically review the findings and recommendations of the consultant it employed for the tariff reset process.

WORKERS PROTEST

¶6. (U) On December 10, the electricity workers union staged a protest march against SIGET's decision to cut distribution tariffs. Electricity workers fear the tariff cuts will force distributors to reduce their workforce in order to cut costs. Union leaders complained that SIGET recommended that distribution companies use subcontractors for 75% of their work.

GOES: TAKE IT OR LEAVE

¶7. (C) AES General Manager Fernando Pujals conveyed his company's concerns during a December 10 meeting with President Saca's private secretary Elmer Charlaix, Technical Secretary Eduardo Ayala Grimaldi, SIGET Superintendent

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Fernando Araujo, Legal Secretary Luis Mario Rodriguez and Communications Secretary Julio Rank. After making his case, Pujals reported that Charlaix asked him, if AES didn't like SIGET's decision, "Why don't you sell (your company)?" Julio Rank cited a World Bank report estimating distributors past profits at 15-18% and suggested that the lean times ahead would average out over the long term with more prosperous periods. Pujals disputed the cited profit figure, noting that AES-El Salvador is a public company whose financial records show roughly 7% annual return on capital. While the two political advisors belittled Pujals' concerns, he reported that Rodriguez and Ayala were silent.

POSSIBLE COMPROMISE?

¶8. (U) Both AES and Ashmore have pressed for a compromise to accept a smaller reduction in distribution tariffs while ensuring continued investment and development of El Salvador's energy sector. They emphasized that the new rate schedule will provide negligible reductions in electricity bills since distribution charges only represent 30% of the average electricity bill. Ashmore estimated that 99% of its clients, who consume less than 100 kwh/month, would save only 20 cents per month. AES said that 62% if its clients fall into the same category. Distributors have suggested the GOES could more effectively help low-income consumers by better focusing subsidies on low-income energy consumers, while excluding larger industrial consumers. According to the state power company, the GOES is already confronting an increasing challenge to cover rising electricity subsidies that may cost $239 million through the mid-2009 election (reftel A).

¶9. (SBU) With the GOES back from holiday vacation, the

distribution companies are continuing to press for a reasonable compromise and have suggested alternative ways for the GOES to help consumers without causing long-term damage to El Salvador's energy sector and erosion of its positive investment climate. Both companies reported signs that the GOES was receptive to their concerns and might mitigate the tariff cuts. On January 9, however, Ashmore manager, Roberto Figueroa told Econoff that Ashmore's "last ditch" lobbying efforts had failed and they do not expect SIGET to amend its decision except by court order.

COMMENT

¶10. (U) SIGET appears to have uncritically accepted the assessment of its consultant who recommended the tariffs cuts that conveniently further the GOES' broader agenda of consumer-friendly policies in advance of the 2009 elections. However, the negligible impact on most consumers' pocket books will not do much to curry favor with them. While larger energy users, supposedly ARENA backers, should benefit more from the rate cuts, they too could suffer if the tariff cuts result in diminished electricity service and they account for far fewer votes. Also, the energy companies are apparently not going to go down without a fight. For the second time in 3 months they are seeking legal action against a GOES entity after appealing a competition case to the Supreme Court in October (see reftel B). This reflects poorly on El Salvador's investment climate and makes it appear that partisan political considerations are trumping sound economic policies.
Glazer